

rules of this section do not apply to income that is not community income. Thus, the rules of this section do not apply to income from property that was formerly community property, but in accordance with state law, has ceased to be community property, becoming, e.g., separate property or property held by joint tenancy or tenancy in common.

(2) When taxpayers report income under paragraph (a) of this section, *all* community income for the calendar year is treated in accordance with the rules provided by section 879(a). Unlike the other provisions under section 66, section 66(a) does not permit inclusion on an item-by-item basis.

(c) *Transferee liability.* The provisions of section 66 do not negate liability that arises under the operation of other laws. Therefore, a spouse who is not subject to Federal income tax on community income may nevertheless remain liable for the unpaid tax (including additions to tax, penalties, and interest) to the extent provided by Federal or state transferee liability or property laws (other than community property laws). For the rules regarding the liability of transferees, see sections 6901 through 6904 and the regulations thereunder.

[T.D. 9074, 68 FR 41070, July 10, 2003]

§ 1.66-2 Treatment of community income where spouses live apart.

(a) Community income of spouses domiciled in a community property state will be treated in accordance with the rules provided by section 879(a) if all of the following requirements are satisfied—

(1) The spouses are married to each other at any time during the calendar year;

(2) The spouses live apart at all times during the calendar year;

(3) The spouses do not file a joint return with each other for a taxable year beginning or ending in the calendar year;

(4) One or both spouses have earned income that is community income for the calendar year; and

(5) No portion of such earned income is transferred (directly or indirectly) between such spouses before the close of the calendar year.

(b) *Living apart.* For purposes of this section, living apart requires that spouses maintain separate residences. Spouses who maintain separate residences due to temporary absences are not considered to be living apart. Spouses who are not members of the same household under § 1.6015-3(b) are considered to be living apart for purposes of this section.

(c) *Transferred income.* For purposes of this section, transferred income does not include a *de minimis* amount of earned income that is transferred between the spouses. In addition, any amount of earned income transferred for the benefit of the spouses' child will not be treated as an indirect transfer to one spouse. Additionally, income transferred between spouses is presumed to be a transfer of earned income. This presumption is rebuttable.

(d) *Examples.* The following examples illustrate the rules of this section:

Example 1. Living apart. H and W are married, domiciled in State A, a community property state, and have lived apart the entire year of 2002. W, who is in the Army, was stationed in Korea for the entire calendar year. During their separation, W intended to return home to H, and H intended to live with W upon W's return. H and W do not file a joint return for taxable year 2002. H and W may not report their income under this section because a temporary absence due to military service is not living apart as contemplated under this section.

Example 2. Transfer of earned income—de minimis exception. H and W are married, domiciled in State B, a community property state, and have lived apart the entire year of 2002. H and W are estranged and intend to live apart indefinitely. H and W do not file a joint return for taxable year 2002. H occasionally visits W and their two children, who live with W. When H visits, he often buys gifts for the children, takes the children out to dinner, and occasionally buys groceries or gives W money to buy the children new clothes for school. Both W and H have earned income in the year 2002 that is community income under the laws of State B. H and W may report their income on separate returns under this section.

Example 3. Transfer of earned income—source of transfer. H and W are married, domiciled in State C, a community property state, and have lived apart the entire year of 2002. H and W are estranged and intend to live apart indefinitely. H and W do not file a joint return for taxable year 2002. W provides H \$1,000 a month from March 2002 through August 2002 while H is working part-time and

seeking full-time employment. W is not legally obligated to make the \$1,000 payments. W earns \$75,000 in 2002 in wage income. W also receives \$10,000 in capital gains income in December 2002. H wants to report his income in accordance with this section, alleging that the \$6,000 that he received from W was not from W's earned income, but from the capital gains income W received in 2002. The facts and circumstances surrounding the periodic payments to H from W do not indicate that W made the payments out of her capital gains. H and W may not report their income in accordance with this section, as the \$6,000 W transferred to H is presumed to be from W's earned income, and H has not presented any facts to rebut the presumption.

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§ 1.66-3 Denial of the Federal income tax benefits resulting from the operation of community property law where spouse not notified.

(a) *In general.* The Secretary may deny the Federal income tax benefits of community property law to any spouse with respect to any item of community income if that spouse acted as if solely entitled to the income and failed to notify his or her spouse of the nature and amount of the income before the due date (including extensions) for the filing of the return of his or her spouse for the taxable year in which the item of income was derived. Whether a spouse has acted as if solely entitled to the item of income is a facts and circumstances determination. This determination focuses on whether the spouse used, or made available, the item of income for the benefit of the marital community.

(b) *Effect.* The item of community income will be included, in its entirety, in the gross income of the spouse to whom the Secretary denied the Federal income tax benefits resulting from community property law. The tax liability arising from the inclusion of the item of community income must be assessed in accordance with section 6212 against this spouse.

(c) *Examples.* The following examples illustrate the rules of this section:

Example 1. Acting as if solely entitled to income. (i) H and W are married and are domiciled in State A, a community property state. W's Form W-2 for taxable year 2000 showed wage income of \$35,000. W also received a Form 1099-INT, "Interest Income,"

showing \$1,000 W received in taxable year 2000. W's wage income was directly deposited into H and W's joint account, from which H and W paid bills and household expenses. W did not inform H of her interest income or the Form 1099-INT, but W gave H a copy of the W-2 when she received it in January 2001. W did not use her interest income for bills or household expenses. Instead W gave her interest income to her brother, who was unemployed. Neither the separate return filed by H nor the separate return filed by W included the interest income. In 2002, the IRS audits both H and W. The Internal Revenue Service (IRS) may raise section 66(b) as to W's interest income, denying W the Federal income tax benefit resulting from community property law as to this item of income.

(ii) H and W are married and are domiciled in State B, a community property state. For taxable year 2000, H receives \$45,000 in wage income that H places in a separate account. H and W maintain separate residences. H's wage income is community income under the laws of State B. That same year, W loses her job, and H pays W's mortgage and household expenses for several months while W seeks employment. Neither H nor W files a return for 2000, the taxable year for which the IRS subsequently audits them. The IRS may not raise section 66(b) and deny H the Federal income tax benefits resulting from the operation of community property law as to H's wage income of \$45,000, as H has not treated this income as if H were solely entitled to it.

Example 2. Notification of nature and amount of the income. H and W are married and domiciled in State C, a community property state. H and W do not file a joint return for taxable year 2001. H's and W's earned income for 2001 is community income under the laws of State C. H receives \$50,000 in wage income in 2001. In January 2002, H receives a Form W-2 that erroneously states that H earned \$45,000 in taxable year 2001. H provides W a copy of H's Form W-2 in February 2002. W files for an extension prior to April 15, 2002. H receives a corrected Form W-2 reflecting wages of \$50,000 in May 2002. H provides a copy of the corrected Form W-2 to W in May 2002. W files a separate return in June 2002, but reports one half of \$45,000 (\$22,500) of wage income that H earned. H files a separate return reporting half of \$50,000 (\$25,000) in wage income. The IRS audits both H and W. Even if H had acted as if solely entitled to the wage income, the IRS may not raise section 66(b) as to this income because H notified W of the nature and amount of the income prior to the due date of W's return (including extensions).

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